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In the Supreme Court of the United States

OCTOBER TERM, 1978

STEERE TANK LINES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
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The question presented in this federal income tax case is whether petitioner's payment of $222,000 into a special account was an insurance premium deductible as a business expense under Section 162 of the Internal Revenue Code of 1954 (26 U.S.C.), or, as both courts below held, a nondeductible deposit into a reserve for accident claims.

The pertinent facts are undisputed and may be summarized as follows: Petitioner, a Texas corporation engaged in the interstate trucking business, was

required by the Interstate Commerce Commission and state regulatory agencies to provide evidence of financial responsibility for payment of potential accident claims. After petitioner's liability insurance was cancelled by its insurance company as a result of its poor accident history, petitioner entered into an arrangement with Tri-State Insurance Company, pursuant to which Tri-State provided a surety bond as evidence of petitioner's financial responsibility. In return, petitioner agreed to pay Tri-State a minimum annual premium of $6,000,[1] and to indemnify Tri-State for all claims against it. To that end, petitioner agreed to fund a "contract premium account" on an annual basis from which all claims against petitioner and Tri-State and administrative expenses would be paid.[2] This fund was to be held and administered by Adjustment and Inspection Company (A & I), a company established by petitioner's two shareholders and owned in trust for their children. The balance in the fund exceeding the amounts paid out for claims and expenses would be returned to petitioner after six years (Pet. App. A-2 to A-3, A-8).

During its taxable year 1972, petitioner paid $222,092.07 into the contract premium account held

[1] The Commissioner agreed that the $6,000 annual premium was nonrefundable and deductible as a business expense (Pet. App. A-3 to A-4).

[2] In addition to funding the contract premium account, petitioner was required to obtain and carry excess insurance. Petitioner also agreed to defend Tri-State against any legal actions arising from the parties' agreement (Pet. App. A-7).

by A & I, and claimed this amount as a deduction on its tax return for that year. On audit, the Commissioner of Internal Revenue disallowed the deduction on the ground that the payment was not a business expense but a nondeductible deposit or reserve.[3] However, the Commissioner allowed petitioner to deduct the $114,422.46 paid out of that account in 1972 in settlement of actual claims and related expenses (Pet. App. A-4, B-7).

In this refund suit brought by petitioner in the United States District Court for the Northern District of Texas, the district court upheld the Commissioner's determination (Pet. App. B-1 to B-7). The court of appeals affirmed per curiam (Pet. App. A-1 to A-5).

The decision below correctly held that petitioner's payment into the contract premium account was a nondeductible payment into a reserve, and not an insurance premium. As this Court ruled in *Commissioner* v. *Lincoln Savings & Loan Assn.*, 403 U.S. 345 (1971), payments into a reserve do not constitute deductible expenses despite their characterization as "premiums," where, as here, the taxpayer retains a proprietary interest in the fund, and there is a possibility that amounts in the fund might be returned to

[3] The Commissioner also maintained, and the district court found (Pet. App. B-7), that the payment did not satisfy the "all events" test of Section 461 of the Code (26 U.S.C.). The court of appeals, however, did not rule on this question.

him. See also *United States* v. *Mississippi Chemical Corp.*, 405 U.S. 298 (1972).[4]

Petitioner renews its argument (Pet. 8-15), rejected by both courts below (Pet. App. A-3 to A-5, B-6 to B-7), that its agreement with Tri-State was a true insurance arrangement. Two fundamental aspects of an insurance arrangement are risk shifting and risk distribution. *Helvering* v. *LeGierse*, 312 U.S. 531 (1941). But neither of those elements is present here. Since petitioner was obligated to pay all claims or losses, it shifted no insurance risk to Tri-State. Indeed, to the extent Tri-State bore any risk at all, it was not an insurance risk but a creditor's risk—*i.e.*, that claims against petitioner would exhaust the contract premium account, exhaust the excess insurance, and render petitioner insolvent. If that contingency occurred, Tri-State would become liable as a surety. As consideration for its acceptance of that risk, Tri-State received from petitioner an annual minimum premium of $6,000, the deductibility of which is not disputed.[5] In sum, the only insurance risk involved in this case is the self-insurance undertaken by petitioner by its establishment of the fund. Amounts deposited into such a fund are deductible when they are used to pay actual claims. *Spring Canyon Coal Co.* v. *Commissioner*, 43 F.2d 78 (10th Cir. 1930).

Moreover, since petitioner was the sole source of all funds paid into the contract premium account, there was no distribution of the risk. The court of appeals therefore found it unnecessary to address the correctness of *United States* v. *Weber Paper Co.*, 320 F.2d 199 (8th Cir. 1963), which petitioner cites (Pet. 5-15) as conflicting with the decision below. In *Weber*, the taxpayer, together with other subscribers, made premium payments for flood insurance to a licensed insurance company, which maintained the premiums in a pooled fund from which flood losses suffered by any subscriber would be paid. Thus, unlike this case, there was an element of risk in *Weber* that shifted to the insurer, which in turn distributed that risk of loss among all subscribers.[6]

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[4] Although the Internal Revenue Code specifically authorizes taxpayers to establish certain reserves and deduct payments made thereto, such as a bad debt reserve under Section 166(c) (26 U.S.C.), other reserves established by taxpayers for legitimate accounting purposes do not generate income tax deductions. *Lucas* v. *American Code Co.*, 280 U.S. 445, 452 (1930); *Brown* v. *Helvering*, 291 U.S. 193, 202 (1934).

[5] Petitioner's own actions contradict its characterization of the deposits to the fund as insurance. Pursuant to ICC regulations, petitioner was required to file with the state either "[1] a currently effective certificate of insurance or [2] surety bond." 49 C.F.R. 1023.52-1023.53, and Forms E and F (certificate of insurance); 49 C.F.R. 1023.54 and Form G (surety bond). As the court of appeals pointed out (Pet. App. A-5), petitioner filed a *surety bond* and not a certificate of insurance with the ICC and the appropriate Texas State agency.

[6] Petitioner also argues (Pet. 15-17) that the payments were dedutible even if they were not "insurance premiums" because it had a fixed liability to make the payments in an ascertainable amount. But as this Court made clear in *Commissioner* v. *Lincoln Savings & Loan Assn.*, *supra*, the fact

Weber is therefore distinguishable.[7]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

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that a payment is required by business exigencies does not render it deductible. See also *Welch* v. *Helvering*, 290 U.S. 111, 113-114 (1933).

[7] In the courts below, the government argued that *Weber* was distinguishable but also that it was wrongly decided. In our view, the proper tax treatment there would have been to limit the deduction to the nonwithdrawable portion of the annal premium deposit. See Rev. Rul. 60-275, 1960-2 Cum. Bull. 43. Because the court of appeals agreed with our primary contention that *Weber* was distinguishable, it was not required to consider the correctness of that decision.

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